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No. 97-

In the
Supreme Court of the United States
OCTOBER TERM, 1997

JAMES TENZER,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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68 pp

QUESTIONS PRESENTED

1. Does the Government violate a taxpayer's rights to due process when it prosecutes him for failure to file tax returns, after that taxpayer voluntarily informed the Internal Revenue Service ("IRS") of that failure to file, and fully complied with the IRS' Voluntary Disclosure Policy, in which the IRS publicly promised that taxpayers satisfying the conditions of that policy would not be prosecuted?

2. Has a taxpayer "made bona fide arrangements to pay" his taxes, within the terms of the IRS' Voluntary Disclosure Policy, where he submitted to the IRS an Offer in Compromise of those liabilities, in accordance with 26 U.S.C. §7122 and the regulations thereunder, but the IRS, in violation of those regulations, began a criminal investigation of the taxpayer without either accepting or rejecting that offer?

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PETITION FOR WRIT OF CERTIORARI

James Tenzer respectfully petitions this Court for a writ of certiorari to review the decision of the United States Court of Appeals for the Second Circuit, which reversed a decision of the United States District Court for the Southern District of New York, which had dismissed a misdemeanor Information charging Mr. Tenzer with four counts of willful failure to file federal income tax returns in violation of 26 U.S.C. §7203.

Decisions Below

The Decision of the United States District Court for the Southern District of New York is reported as United States v. Tenzer, 950 F. Supp. 554 (S.D.N.Y. 1996) and is reproduced at App. 1-19.[1] The decision of the United States Court of Appeals for the Second Circuit is reported as United States v. Tenzer, 127 F.3d 222 (2d Cir. 1997), and is reproduced at App. 20-35.

Jurisdiction of this Court

The Decision of the Second Circuit was issued on September 17, 1997. (App. 20). Mr. Tenzer timely filed a Petition for Rehearing with that court on October 17, 1997; that Petition for Rehearing was denied on November 6, 1997. (App. 36). On January 27, 1998, Justice Ginsburg signed an order extending the date for filing this petition for certiorari to and including March 23, 1998. This Court's jurisdiction is invoked pursuant to 28 U.S.C. §1254(1).

Constitutional Provisions, Statutes and Regulations

The Fifth Amendment to the Constitution of the United States provides, in pertinent part: "No person shall be ... deprived of life, liberty or property, without due process of law..."

The following statutes and regulations are reproduced in the Appendix to this Petition, beginning at page App. 37: 26 U.S.C. §7203; 26 U.S.C. §7122; 26 C.F.R. §301.7122-1(d); 26 C.F.R. §601.203; Internal Revenue Manual, Handbook for Special Agents, §342.142 (1993).

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[1] References preceded by "App." Are to the Appendix to this Petition; references preceded by "CAA" are to the Joint Appendix filed with the Court of Appeals; references preceded by "Tr." are to the transcript of the evidentiary hearing conduced by the District Court (which was also before the Court of Appeals).

STATEMENT OF THE CASE

Mr. Tenzer's Tax Returns

James Tenzer is a tax attorney with a large public accounting firm in Garden City, New York. For many years between 1976 and 1991, he filed his tax returns late or, for two of those years, not at all. The Internal Revenue Service was fully aware of his existence and of his receipt of income (which was reported to the IRS by the partnerships or other payors from which he received such income), but treated his delinquent filings as civil, not criminal, matters. (App. 2).

In March 1991, after Mr. Tenzer received several computer generated notices from the IRS regarding his failure to file tax returns for 1986-89, he contacted an attorney to help him file these returns. (App. 2-3). After receiving another computer-generated notice, Mr. Tenzer's attorney contacted the IRS and obtained extensions of time in which Mr. Tenzer could file his returns without the IRS commencing any enforcement action. Mr. Tenzer filed his returns for the years 1986-1989 early in 1992. The IRS has never disputed the accuracy of those late-filed returns, and they were "cleared" for collection by the IRS. (App. 4). (As the record in this case reflects, when the IRS is investigating possible *criminal* wrongdoing by a taxpayer, it *suspends* all civil collection efforts, and puts a "freeze" on a taxpayer's account. (App. 8 n.2)).

The Offer in Compromise

A Revenue Officer (collection agent) of the IRS thereafter met with Mr. Tenzer's attorney. Mr. Tenzer's attorney then explained that Mr. Tenzer was unable to pay his delinquent taxes in full. Mr. Tenzer's attorney first proposed an installment agreement, pursuant to which he would make full payment over time; later, after the Revenue Officer expressly assured Mr. Tenzer's attorney that Mr. Tenzer's voluntary disclosure was being handled as a civil matter, the attorney proposed an Offer in Compromise, under which Mr. Tenzer would pay the IRS a lump sum (plus a percentage of his future earnings) in satisfaction of his entire tax debt. (App. 5).[2]

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[2] During these negotiations, the IRS agent demanded that Mr. Tenzer file his tax returns for 1990 and 1991; Mr. Tenzer did so. (App. 5).

In February 1993, Mr. Tenzer, through his attorney, an experienced tax attorney and former IRS official, filed an Offer in Compromise covering the years 1986-1991, accompanied by a detailed financial statement. (App. 5-6; the actual Offer in Compromise is reproduced at CAA 71-86). The Offer proposed that Mr. Tenzer pay the lump sum of $250,000 within 30 days of its acceptance. If accepted, the Offer would have resulted in *all* of Mr. Tenzer's assets being liquidated and the proceeds paid to the IRS. (CAA 151). Additionally, Mr. Tenzer offered to pay the IRS a percentage of his earnings for the next ten years. (CAA 151; Tr. 484).

The District Court specifically found that the Offer in Compromise was submitted by Mr. Tenzer in good faith reliance on the advice of his experienced tax counsel. (App. 15). The IRS agent determined that the Offer was neither facially inadequate nor made in bad faith. After the Offer was reviewed by the agent and her supervisor, the IRS forwarded the Offer to the IRS Service Center in Maine for processing. (App. 6).

In April 1993, that Service Center "returned" the Offer in Compromise to Mr. Tenzer. The only basis identified by the IRS for returning the offer was that he had not offered an amount "equal to or in excess of" the "equity in assets" figure shown on his financial statement. (CAA 87). In fact, the IRS was mistaken: Mr. Tenzer's Offer in Compromise was -- in accordance with IRS rules -- computed based on the "forced sale" value of Mr. Tenzer's assets. (Tr. 482; CAA 88-89, 149-50, 553-54)).

Although both the District Court (App. 15) and the Court of Appeals (App. 32) referred to the Offer in Compromise as having been "rejected," the IRS' letter to Mr. Tenzer (reproduced at CAA 87) does not speak in terms of "rejection" at all. Instead, it states that the Offer "is being returned to you because it is not processable," and explicitly invited Mr. Tenzer to resubmit the Offer. (CAA 87). (*See also* discussion at pp. 13-14, *infra*).

Immediately upon receiving the IRS' letter, Mr. Tenzer's attorney notified the IRS that he would be resubmitting the Offer in Compromise. The attorney explained why the IRS' position -- that the Offer was "not processable" because it had not offered a sufficient amount --was erroneous and in contravention of IRS' own rules. (CAA 88-89). Before Mr. Tenzer's attorney had an

opportunity to resubmit the Offer, the Revenue Officer informed him that Mr. Tenzer's account was being transferred from Manhattan to the IRS' Brooklyn district office; the Officer instructed Mr. Tenzer's attorney to wait to be contacted by that district before resubmitting his Offer. (Tr. 435-36, 484-85).

No contact was ever initiated by the Brooklyn district office. Instead, in June 1993, the IRS instituted a criminal investigation of Mr. Tenzer, and put a "freeze" on all efforts to collect his tax liabilities. (App. 8). Ultimately, on November 30, 1995, the government charged Mr. Tenzer with four counts of failing to file his tax returns for the years 1987-90.

The IRS' Voluntary Disclosure Policy

Since at least 1952, the IRS has had a policy, which has changed somewhat over time, to encourage taxpayers who have failed to file tax returns to re-join the tax system and resume voluntary compliance with the tax laws. (App. 9).

As of 1992, more than 10 million taxpayers had failed to file their income tax returns and collectively owed more than $7 billion in unpaid taxes *per year*. (CAA 57, 108, 112). Moreover, the IRS' inventory of unfiled returns grew by more than 30% in 1991 alone. (CAA 57, 108). The IRS, concerned at the growing rate of nonfiling, decided to raise public awareness of its Voluntary Disclosure Policy in order to assuage taxpayer's fears and to encourage them to rejoin the system. (CAA 60, 104-105). As the District Court observed, in furtherance of this effort to raise public awareness and to bring these nonfilers back in to the system, the IRS made a series of public pronouncements "with much public fanfare" to induce taxpayers to come forward and disclose past failures to file. (App. 9).

The terms of that Policy were that the IRS would *not* "recommend the criminal prosecution of an individual who comes forward voluntarily to report the failure to file of one or more tax returns... where the person:

a. informed the IRS that he/she has not filed tax returns for one or more tax[able] periods;

b. had only legal source income, in other words no part of the income was earned from activity which is illegal under federal or state law;

c. made the disclosure prior to being contacted by the IRS -- in this context, "contact by the IRS" means that the taxpayer and/or the taxpayer's representative has received notification by the IRS by a telephone call, letter or personal visit that the taxpayer is under criminal investigation;

d. either filed a true and correct tax return or cooperated with the IRS in ascertaining the correct tax liability; and,

e. either paid in full the amount due or, in those situations were the taxpayer was unable to make full payment, made bonafide arrangements to pay."

IRS News Release, IR-92-114 (Dec. 7, 1992) (CAA 63, 117). *Accord*, IRS Handbook for Special Agents §342.142 (April 5, 1993) (App. 44-45); Internal Revenue Manual §(31) 330 (June 24, 1994) (CAA 54).

The IRS' public advertising of this policy during 1992 and 1993 included the following statements:

- "The IRS has *never* recommended criminal prosecution to Department of Justice when taxpayers came forward and made a true voluntary disclosure of failing to file returns and filed accurate returns of their own volition." IRS Fact Sheet, FS-92-5 (Sept. 30, 1992) (CAA 58, 111) (emphasis added).
- "It is never too late to get right with your Government.... [T]axpayers who come forward voluntarily to file their delinquent returns should not fear criminal prosecution." Statement of IRS Commissioner Shirley Peterson, IRS News Release, IR-92-94 (Sept. 30, 1992) (CAA 113, 115).
- "The IRS will *not* recommend criminal prosecution of *any* taxpayer who comes forward, makes a true voluntary disclosure, and files an accurate tax return." Statement of IRS Commissioner Shirley Peterson, IRS

News Release, IR-92-94 (Sept. 30, 1992) (CAA 60a) (emphasis added).

- The IRS has "a long-standing practice of not recommending prosecution of nonfiler cases when the taxpayer voluntarily discloses nonfiling." Statement of Commissioner Peterson, IRS News Release, IR-92-114 (December 7, 1992) (CAA 62-63, 116-17).
- "Our long-standing practice has been not to recommend criminal prosecution of individuals for failure to file tax returns -- provided they voluntarily file, or make arrangements to file, before being notified they are under criminal investigation." IRS Pub. 1715 ("It's Never Too Late!") (July 1993) (CAA 172).
- "For those who fear criminal prosecution, our long-standing practice, and it long predates the nonfiler program, has been not to recommend criminal prosecution for individuals for failure to file tax returns if they filed or made arrangements to file voluntarily before being notified they were under criminal investigation; made an honest effort to file correct returns; derived their income exclusively from legal sources; and paid all amounts due, or made arrangements for payment." Taxpayers Who Fail to File Federal Income Tax Returns: Hearing Before the Subcomm. on Oversight of the Comm. on Ways and Means, 103d Cong., 1st Sess. at 12 (Oct 12, 1993) (Testimony of IRS Commissioner Margaret Milner Richardson).

It is this policy which the District Court found the IRS violated in this case. (App. 15).

Proceedings Below

On November 30, 1995, the Government charged Mr. Tenzer, in a four-count Information, with failure to file tax returns for the years 1987-90, allegedly in violation of 26 U.S.C.

§7203. (App. 1-2).[3] Mr. Tenzer moved to dismiss the Information, on the ground, *inter alia*, that the IRS violated his constitutional rights by prosecuting him in violation of its publicly-announced Voluntary Disclosure Policy. (App. 1). The United States District Court for the Southern District of New York (Hon. Charles L. Brieant, U.S.D.J.), after conducting a four-day evidentiary hearing (*see* App. 2), issued a decision on September 10, 1996, dismissing the Information "on the ground that defendant complied with and is protected by the Internal Revenue Service's Voluntary Disclosure Policy." (App. 19). That court found that the IRS is constitutionally required to comply with its own published policies, even if they afford taxpayers greater protection than would have otherwise have been required. (App. 1) (*citing* United States v. Caceres, 440 U.S. 741, 751 n.14 (1979)).

The Government appealed this decision to the United States Court of Appeals for the Second Circuit. That court reversed the district court's decision in an opinion issued on September 19, 1997. (App. 20-35). The Court of Appeals did not reach Judge Brieant's determination that the Due Process Clause requires the IRS to adhere to its Voluntary Disclosure Policy, because it found that Mr. Tenzer had not fully complied with that policy. (App. 28 n.1). While the court did not take issue with the district court's findings that Mr. Tenzer satisfied four of the five conditions for complying with the Voluntary Disclosure Policy, it held that Mr. Tenzer failed to satisfy the fifth condition because he had not either paid his taxes or "made arrangements to pay." (App. 30-32).

The Court of Appeals recognized that an Offer in Compromise will satisfy this prong of the Voluntary Disclosure Policy. (App. 30-31). It further held that "the government is obligated to negotiate in good faith with the taxpayer toward the end of achieving an arrangement to pay... [and] may not withhold its assent capriciously or in bad faith. The IRS must afford a taxpayer who acted in reliance upon the voluntary disclosure policy a reasonable opportunity to satisfy all of the conditions of that policy, including a payment plan." (App. 31). Nevertheless, the Court of Appeals held, Mr. Tenzer did not satisfy the Policy

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[3] The District Court had jurisdiction pursuant to 18 U.S.C. §3231.

because his Offer in Compromise was "firmly (and predictably) rejected," and not increased thereafter by Mr. Tenzer. (App. 32).

REASONS FOR GRANTING THE WRIT

The decision of the Second Circuit is erroneous, for it seriously misconstrues and ignores the statutes, rules and regulations governing Offers in Compromise. More importantly, its decision seriously jeopardizes two important national policies, the IRS' Voluntary Disclosure Policy and its Offer in Compromise program, both of which play vital roles in securing voluntary compliance with our nation's income tax system.

1. The Due Process Clause Requires the IRS to Abide By Its Published Voluntary Disclosure Policy

The district court found that Mr. Tenzer had fully complied with the IRS' Voluntary Disclosure Policy by having income from only lawful sources; filing accurate, delinquent tax returns, prior to being notified that he was under criminal investigation; and by making good-faith efforts to settle his tax obligations. That court further concluded that the Government nevertheless prosecuted Mr. Tenzer in defiance of its own published policies. The district court correctly held that it could not properly countenance such conduct on the part of the government. As this Court has held, "[w]here the rights of individuals are affected, it is incumbent upon agencies to follow their own procedures. This is so even where the internal procedures are possibly more rigorous than would otherwise be required." United States v. Caceres, 440 U.S. 741, 751 n. 14 (1979) (*quoting* Morton v. Ruiz, 415 U.S. 199, 235 (1974)).[4]

This principle "is premised on fundamental notions of fair play underlying the concept of due process." Montilla v. INS, 926 F.2d 162, 167 (2d Cir. 1991). *Accord*, International House v. NLRB, 676 F.2d 906, 912 (2d Cir. 1982). It applies "even where

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[4] *See also* Service v. Dulles, 354 U.S. 363, 388 (1957) (employee dismissal reversed where regulations requiring undersecretary's review not followed); Accardi v. Shaughnessy, 347 U.S. 260 (1954) (relief granted where deportation procedures not followed); Massachusetts Fair Share v. Law Enforcement Assistance Adm'n, 758 F. 2d 708, 711 (D.C. Cir. 1985) ("It has long been settled that a federal agency must adhere firmly to self-adopted rules by which the interests of others are to be regulated").

discretionary decisions are involved," Smith v. Resor, 406 F.2d 141, 145 (2d Cir. 1969) (Kaufman, J.), and "is not limited to rules attaining the status of formal regulations." Montilla, 926 F.2d at 167.

This Court has previously applied this doctrine to overturn criminal convictions. In Yellin v. United States, 374 U.S. 109 (1963), this Court overturned a conviction for contempt of Congress when the congressional committee did not follow its own rules in compelling the witness' testimony, even though those rules gave the witness rights broader than the Constitution or governing statutes. Similarly, in Raley v. Ohio, 360 U.S. 423 (1959), the Court held that due process precluded the conviction of individuals for refusing to answer questions if they were given assurances, express or implied, that they had the right not to answer.

In this case, the district court applied these principles in a straightforward way. The district court found that Mr. Tenzer complied with the IRS Voluntary Disclosure Policy and that the IRS violated that Policy by recommending Mr. Tenzer's prosecution. These findings are amply supported by the record, as discussed above. The district court further found that the IRS' violation of its own policy constituted a denial of Mr. Tenzer's right to due process because the IRS promoted its Policy for the specific purpose of inducing taxpayer reliance, secured Mr. Tenzer's cooperation through such reliance, and then prejudiced Mr. Tenzer by seeking criminal charges against him notwithstanding the IRS' numerous public assurances that it would not pursue such charges against taxpayers who complied with the Policy. (App. 16-17).

The Court of Appeals did not overturn the district court's decision that the IRS' violation of its own policy violated Mr. Tenzer's constitutional rights. (App. 28 n. 1). Instead, it held that Mr. Tenzer had not complied with that policy by failing to reach an agreement with the IRS on an Offer in Compromise. (App. 30-32). That holding, however, is erroneous, for the reasons set forth immediately below.

2. The IRS Arbitrarily Violated Its Own Regulations in its Handling of Mr. Tenzer's Offer in Compromise

The district court, after a four-day evidentiary hearing, determined that Mr. Tenzer had submitted a good faith Offer in Compromise, and thereby satisfied that portion of the Voluntary Disclosure Policy requiring that a taxpayer who discloses a prior failure to file tax returns "make bona fide arrangements to pay" any delinquent taxes. (App. 11, 15). The Second Circuit reversed this determination, but it was the Second Circuit, and not the district court, which erred as to the rules governing the important Offer in Compromise program.

The Second Circuit recognized that a taxpayer may satisfy the Voluntary Disclosure Policy through an Offer in Compromise. (App. 30-31). It further recognized that, if the taxpayer attempts to negotiate such a compromise, "the government is obligated to negotiate in good faith with the taxpayer toward the end of achieving an arrangement to pay" (App. 31), and "may not withhold its assent capriciously or in bad faith" (*Id.*). Nonetheless, the Second Circuit held that Mr. Tenzer did not satisfy the Policy because his Offer in Compromise was "was firmly (and predictably) rejected" as being too low, and was not increased thereafter (App. 32).

In fact, as we demonstrate more fully below, the record shows that:

1. Mr. Tenzer's offer was bona fide, and was made in accordance with the law and the regulations, rules, procedures and policies promulgated by the IRS;

2. The IRS entertained the offer as bona fide;

3. The IRS *never rejected* Mr. Tenzer's offer. Rather, when it returned Mr. Tenzer's Offer in Compromise, the IRS explicitly invited its resubmission (CAA 87); and

4. As a matter of law, the IRS could not have rejected Mr. Tenzer's Offer, without first affording him a number of procedural rights (including the right to an administrative appeal), which it did not do. Rather, the IRS told Mr. Tenzer that he should resubmit his Offer, but then, before he could do so, it aborted the Offer in Compromise process, in violation of its own published

regulations and policies, precluding Mr. Tenzer from reaching an agreement to satisfy his tax liabilities.

The power to compromise tax liabilities has been vested by Congress with the IRS, 26 U.S.C. §7122(a) (App. 38); and, as this Court has long recognized, in administering this power, the IRS is required to follow all the procedural formalities provided for by law. Botany Worsted Mills v. United States, 278 U.S. 282, 288-89 (1929). This is especially the case where, as here, the IRS' failure to follow its own rules and regulations results in criminal consequences to the taxpayer. Here, Mr. Tenzer followed all the rules and regulations governing offers in compromise, but the IRS repeatedly ignored them.

To begin with, Mr. Tenzer's Offer of $250,000 was in accordance with IRS practice. The IRS' own published procedures specifically permit an Offer in Compromise in a "case involving a large liability and a nominal offer." Rev. Proc. 80-6, §4.01, 1980-1 CB 586. Such an offer may be accepted if "based in whole or part on inability to pay" and if accompanied by "additional consideration" in the form of "collateral agreements" such as an agreement to make additional "payments from future income." *Id.* That is precisely the offer Mr. Tenzer made here: to pay the IRS 10% of his future income, in addition to the amount offered with his Offer in Compromise. (Tr. 484; CAA 151). Indeed, in 1996 (the most recent year for which published figures are available), the IRS accepted offers in compromise in which it satisfied an aggregate of $2.17 billion in taxes for only *13%* of that amount, or $287 million. Wall Street Journal, "Tax Notes," p. 1 col. 5 (March 26, 1997). Here, Mr. Tenzer's proposed lump sum payment, *standing alone*, would have satisfied *24%* of his outstanding tax liabilities. (CAA 40, 71-86). Mr. Tenzer's collateral agreement to pay additional sums out of future earnings would have significantly added to that amount.

Moreover, the offer of $250,000 was not unreasonably low. Rather, it was made in accordance with law since it was properly based on "forced sale" values of Mr. Tenzer's assets. (*See* CAA 88-89, 149-50, 553-54; Tr. 482). Mr. Tenzer's offer was thus commensurate with his ability to pay. (*See* CAA 150-51, 182). That is all the IRS' own rules require with respect to an Offer in Compromise. IRS Chief Counsel Directives Manual, Part (31)330, §4(d) (1991); *see* CAA 126. Indeed, James E.

Donelson, the Acting Chief Compliance Officer of the IRS, recently confirmed in a published article that liquidation value has been, and remains, the proper standard for valuing assets in an Offer in Compromise. J. Donelson, "Offers in Compromise Program Alive and Well," Tax Notes, Sept. 1, 1997 at 1249. Moreover, the IRS has instructed its Revenue Officers as follows:

> It should be recognized ... that the acceptance of an offer serves the best interest of the government.... Since valuations of property ... are not scientifically exact, care should be exercised to avoid inflexible, nonnegotiable values.... Rejection of an offer solely based on narrow asset and income evaluations should be avoided. The Service should attempt to negotiate offer agreements which are in the best interest of all parties.

Internal Revenue Manual, 57(10)(10).1(2), (5) (1992) (emphasis added).

The Offer in Compromise also completely satisfied the IRS' technical requirements. It was properly completed, properly executed and timely submitted on the required form by Mr. Tenzer, pursuant to the advice of his experienced tax counsel. (App. 15; CAA 69-71; Tr. 479). Mr. Tenzer relied on his counsel's advice throughout his negotiations with the IRS; his counsel possessed extensive training, experience and knowledge of the law, rules, regulations, procedures and policies concerning offers in compromise and the collection process. (App. 15; CAA 147-48). Moreover, the Offer was submitted at the express invitation of the IRS Revenue Officer, who was seeking to negotiate an amicable civil resolution of Mr. Tenzer's tax liabilities.

In short, Mr. Tenzer fully complied with the IRS' regulations, rules and policies governing the submission of Offers in Compromise. Once Mr. Tenzer's Offer in Compromise was submitted, it was incumbent upon the IRS, under its own regulations and rules, to take one of three steps: (1) accept the offer, (2) negotiate in good faith with Mr. Tenzer toward a mutually acceptable alternative, or (3) reject the offer, and afford Mr. Tenzer all the procedural rights that attach to such a decision. *See* 26 C.F.R. §601.203(c) (App. 41).

It is undisputed that the IRS neither accepted the Offer nor negotiated with Mr. Tenzer after he submitted his Offer. Moreover, as we demonstrate below, the IRS never rejected the Offer.

1. The IRS' regulations provide that only a "frivolous" offer in compromise, or an offer submitted for the purpose of delaying the collection of tax liabilities, is to be rejected immediately. 26 C.F.R. §301.7122-1(d)(4) (App. 39). Here, the IRS never asserted that Mr. Tenzer's Offer in Compromise was frivolous or made in bad faith. (*See* App. 6). To the contrary, the Revenue Officer determined that the Offer was neither facially inadequate nor made in bad faith, and forwarded it to an IRS service center for processing. (*Id.*)

2. The plain language of the IRS' letter reflects that it was not a "rejection" of Mr. Tenzer's offer. Most important, it does not state anywhere that Mr. Tenzer's offer was being "rejected." Moreover, the letter contains none of the information that the IRS' published procedures require to be included in a letter rejecting an Offer in Compromise. Internal Revenue Manual, 57(10)(17).6(1) (1992); *id.*, Exhibit 5700-36 ("Pattern Letter" 238(P)). The IRS' return of the Offer to Mr. Tenzer as being administratively unprocessable, with instructions to resubmit it, bespeaks not rejection but rather an invitation to continue good faith negotiations. Indeed, the Government has long recognized that Offers in Compromise "involve mutual concessions" and that, accordingly, "[t]here must be room for the 'play of give and take.'" Op. A.G. 6, XIII-2 C.B. 442, 443 (1933) (citations omitted).

3. Only certain IRS officials ("directors" or "regional commissioners") may reject an Offer in Compromise involving tax liabilities over $100,000, as was the case here. 26 C.F.R. §601.203(c)(4); Rev. Proc. 80-6, §2.01(2), 1980-1 C.B. 586. No such official took any such action in the instant matter.

4. When an offer in compromise is rejected, it is subject to review by the Regional Commissioner. 26 C.F.R. §601.203(c)(3). No such review occurred in this case.

5. When an Offer in Compromise ~~is~~ rejected, the stay with respect to collection activity is vacated. This did not occur in this case, inasmuch as the IRS continued its freeze on all collection activity. *See* 26 C.F.R. §301.7122-1(d)(2); Tr. 486.

6. Most importantly, when an Offer in Compromise is rejected, the taxpayer must be informed that he or she may request consideration of the case by the IRS's Appeals Office. 26 C.F.R. §601.203(d); Internal Revenue Manual 57(10)(17).6(4). Mr. Tenzer was never so informed. Moreover, the taxpayer is entitled to a hearing before the Appeals Office. Rev. Proc. 80-6, §6.02, 1980-1 C.B. 586. Mr. Tenzer was not afforded any administrative appeal. At such an appeals hearing, Mr. Tenzer could have demonstrated that the amount he had offered was indeed commensurate with his actual ability to pay. (*See* CAA 150-51, 182). That is all that the IRS' own rules require with respect to an Offer to Compromise. IRS Chief Counsel Directives Manual, Part (31)330, §4(d) (1991).

Thus, it is beyond doubt that Mr. Tenzer's Offer in Compromise was not "rejected" by the IRS. In fact, the Offer was merely returned for resubmission, on the sole ground that the Offer did not equal or exceed Mr. Tenzer's equity in assets. And even that ground was erroneous and improper, for it ignored the fact that the Offer was based – in accordance with IRS' own rules -- on the "forced sale" value of Mr. Tenzer's assets that would be obtainable in order to satisfy the lump sum payment contemplated by the Offer.

In any event, even had the IRS rejected Mr. Tenzer's Offer in Compromise, such rejection would have been arbitrary and capricious, because it in no way complied with the procedural and substantive requirements of the IRS' own regulations and would have deprived Mr. Tenzer of critical opportunities to secure review and reconsideration of any such rejection. Moreover, having asked Mr. Tenzer to resubmit a valid, bona fide offer on an incorrect premise, the IRS compounded its errors by abruptly and summarily terminating its negotiations with Mr. Tenzer regarding the repayment of his taxes, instituting a freeze on collection activity, and initiating criminal proceedings against him for failing to file his returns.

In short, the record is clear that the IRS, in its haste to "to make some charge of some sort stick against" Mr. Tenzer (in the words of the district court) (App. 8), did not follow any of the procedural steps it is required to take in order to reject an Offer in Compromise.

As this Court has held, an administrative agency acts arbitrarily and capriciously when it violates its own published rules and procedures. *See, e.g.*, United States v. Caceres, 440 U.S. 741, 753-54 (1979). The record in this case clearly demonstrates that the IRS arbitrarily violated its own regulations, rules, procedures and policies in its handling of Mr. Tenzer's Offer in Compromise. In doing so, it not only violated Mr. Tenzer's rights, but also threatened important policies of national application.

3. The Decision of the Court of Appeals Threatens Important Policies of National Application

Our income tax system has always been based upon the principle of self-assessment, which requires voluntary self-reporting by taxpayers. *See, e.g.*, California Bankers Ass'n v. Schultz, 416 U.S. 21, 60 (1974) (*citing* Helvering v. Mitchell, 303 U.S. 391, 399 (1938)). However, some taxpayers, for a variety of reasons, lapse into noncompliance and fail to file returns when due. These taxpayers often continue in this nonfiling status for fear that renewed filing will trigger investigation or even criminal prosecution. For this reason, the IRS has long maintained a policy of encouraging delinquent taxpayers to come forward voluntarily, disclose their nonfiling, and rejoin the ranks of compliant tax filers. (App. 9). As part of this program, the IRS announced, with what the district court correctly observed was "much public fanfare" (App. 9), that "[i]t is never too late to get right with your government," IRS News Release IR-92-94 (Sept. 30, 1992), and that "[t]he IRS has *never* recommended criminal prosecution to the Department of Justice when taxpayers come forward and made a true voluntary disclosure of failing to file returns and filed accurate returns of their own volition," IRS Fact Sheet, FS-92-5 (Sept. 30, 1992) (emphasis added). *See* pp. 4-6, *supra*.

Likewise, the Offer in Compromise program is an integral component of our nation's income tax system. It serves to promote voluntary compliance with the tax system. The IRS' own manual recognizes that the Offer in Compromise program is "in the best interest of both the taxpayer and the Service." Internal Revenue Manual 57(10)1.1. From the IRS' standpoint, an offer in compromise can result in the collection of taxes "at the earliest possible time and at the least cost to the Government," *id.*; and from the taxpayer's point of view, the IRS' acceptance of an offer

gives the taxpayer "a fresh start toward compliance with all future filing and payment requirements," *id.* Significantly, these goals precisely mirror those of the Voluntary Disclosure Policy, which is likewise designed to bring delinquent taxpayers back into the system. (App. 9).

Thus, the goals of both the Offer in Compromise program and the Voluntary Disclosure Policy converge. The goals will be thwarted if the IRS may arbitrarily refuse to follow its own clear rules and regulations in terminating an offer in compromise proceeding or prosecuting a taxpayer who has made a voluntary disclosure. This is precisely what the IRS has done to Mr. Tenzer.

It is important that this Court grant review in this case. If the IRS' arbitrary actions as illustrated in this case are allowed to stand, the harm will not be one that could be remedied in future cases. Rather, the result will be to create grave uncertainty for taxpayers and practitioners alike in deciding whether to make voluntary disclosures or to pursue offers in compromise, and ultimately to discourage taxpayers from participating in either of these two important programs. The harm to public confidence in the integrity and fairness of the IRS -- and ultimately to the fundamental principle of voluntary tax compliance -- will be "invisible" but nonetheless real. And this, in turn, will have potentially large financial ramifications for our nation's tax collection system.

This Court also should take this opportunity to make it clear that the IRS, like all governmental agencies, is required to follow its own rules and regulations. If anything, the importance of this principle is greatest when it is the IRS' conduct that is at issue. As one court has observed, "when a compromise of tax liability is at issue, the need for rigorous compliance with pertinent regulations may be at its greatest, for not only the integrity of the public fisc but also public faith in the equitable enforcement of the tax laws hangs in the balance." Boulez v. Comm'r, 810 F.2d 209, 218 (D.C. Cir.), *cert. denied*, 484 U.S. 896 (1987). By criminalizing a civil tax collection matter in disregard of the rules and regulations that bind it, the IRS violated the central tenet that "[w]here the rights of individuals are affected, it is incumbent upon agencies to follow their own procedures." Caceres, 440 U.S. at 751 n.14. This Court should make it clear that the IRS, no less

than the taxpayer, must scrupulously abide by its own rules and regulations.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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March 23, 1998

APPENDIX

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------x

UNITED STATES OF AMERICA,

Plaintiff,

-against-

JAMES L. TENZER,

Defendant.

----------x

95 Cr. 1016 (CLB)

MEMORANDUM AND ORDER

Brieant, J.

By motion docketed March 4, 1996, James L. Tenzer, the single defendant in a four count misdemeanor Information filed November 30, 1995, charging failure to file income tax returns, seeks to dismiss the Information on grounds that his Constitutional rights were violated by the filing of the charges, and that he is entitled to immunity granted by the Internal Revenue Service ("IRS"). Alternatively, Mr. Tenzer seeks to dismiss Count One on the ground that it is time barred and to suppress certain statements and documents received by the Government from Mr. Tenzer prior to the filing of the criminal Information and all leads and other derivative evidence derived therefrom.

For the most part, the motion is based on the IRS Voluntary Disclosure Policy (the "Policy") discussed below, and the so-called "Caceres doctrine" which holds that once an agency adopts regulations they are duty bound to obey them, even if the agency was not required by the Constitution to adopt them in the first instance. The doctrine was set forth in United States v. Caceres, 440 U.S. 741 (1979), where the Supreme Court noted that:

> "Our decisions in Lopez and White demonstrate that the IRS was not required by the Constitution to adopt these regulations.[14]
>
> [Footnote 14 reads as follows:]

> It does not necessarily follow, however, as a matter of either logic or law, that the Agency had no duty to obey them. 'Where the rights of individuals are affected, it is incumbent upon agencies to follow their own procedures. This is so even where the internal procedures are possibly more rigorous than otherwise would be required.' (Citations omitted.)

Id. at 751, n. 14.

The misdemeanor Information charges defendant Tenzer with having unlawfully, willingly and knowingly failed to make income tax returns for the calendar years 1987, 1988, 1989 and 1990. The Information charges that during each of those years the gross income of the defendant ranged between $261,488.00 and $717,344.00.

The following facts were developed at an evidentiary hearing or are presumed to be true for purposes of the motion. Defendant himself did not testify at the hearing.

Mr. Tenzer is an experienced tax attorney and one of the principals of Margolin, Winer and Evens, described as a large accounting firm located in Long Island New York. It is clear that defendant received substantial income during the four years charged and paid little or no estimated tax. The primary source of his income was from approximately six partnerships. The fact of his existence and his receipt of funds from the partnerships was fully known at all times to the IRS. During the period 1976 through 1991, Mr. Tenzer filed his tax returns timely only for the years 1983, 1984, and 1985. Mr. Tenzer never filed any tax return at all, nor did he pay any tax for the years 1978 and 1979[1]. During this period, the IRS treated the repeated incidents of late filing only as a civil, not a criminal matter, and did nothing about 1978 and 1979.

On February 29, 1988, the IRS sent Mr. Tenzer a computer generated notice stating "we have not received your tax

[1] Prosecution for the failure to file returns for these two years is now barred by the statute of limitations, and the right to collect is also lost.

return" for 1986, and requesting that a return be filed. (Gov. Ex. 2.) Additional notices were sent on April 25, 1988, (Gov. Ex. 3,) and June 6, 1988. (Gov. Ex. 4.) On July 18, 1988, the IRS sent another warning that "we may have to . . [b)egin criminal proceedings ... if you willfully fail to file a tax return." (Gov. Ex. 5.)

Despite these notices, the first evidence of Mr. Tenzer's intent to comply with IRS filing requirements did not occur until March 29, 1991, when he retained Steven Solomon, Esq., also an experienced tax practitioner, to assist him in filing his returns.

For many years, the Margolin firm, through Mr. Tenzer, acted as the tax accountants for a major real estate enterprise in Westchester County known as "JRD". JRD, its principals and several of its employees were under Grand Jury investigation, not only for income tax violations but for other crimes, including violations of the Taft Hartley law, making false statements and similar activities. This was a lengthy and elaborate investigation.

In July of 1991, the Margolin firm was notified by JRD that JRD had been served with a Federal Grand Jury subpoena seeking records in correction with a Title 26 tax investigation of JRD.

In November 1991, the Margolin firm was itself served with a Federal Grand Jury subpoena calling for the production of the accounting firm's documents relating to JRD. This service was effected on Mr. Tenzer by Special Agent Trezza of the IRS, who testified before me. Mr. Trezza recalled that upon the service of the subpoena upon Mr. Tenzer, which showed on its face that it was in connection with an investigation of JRD under Section 7201 of Title 26, Mr. Tenzer displayed considerable nervousness and inquired whether "his personal taxes were the subject of the investigation." (Transcript, 394.) This was an unusual reaction for a tax accountant in the experience of Agent Trezza. While the Court finds Mr. Trezza's testimony credible in all respects, I decline to find the weight and significance which the Government attributes to this event. The Government now argues that this service of process (unrelated to Tenzer's own records) was a triggering event which constituted a "contact" by the IRS "notifying" the taxpayer that he was under criminal investigation

for failure to file, a relevant issue under the Policy. This Court rejects this inference.

There is a high level of suspicion attached to Tenzer's activities as a possible aider and abettor of JRD's tax frauds. His nervousness, and inquiry about his own taxes may merely reflect a consciousness of guilt concerning JRD. Reading the Policy literally, service of a subpoena to produce the records of a crooked client does not, as a matter of law, arise to a level of notification that the record custodian's own failure to file was known, or under criminal investigation, and indeed, at that point in time it was not. This "triggering event" is also discounted by this Court's finding that by the spring of 1991, prior to the service of the JRD subpoena, Mr. Tenzer had retained Mr. Solomon to assist him in becoming current on his obligations to the IRS. (Transcript, 310.)

On October 7, 1991, by another computer generated notice as a result of activity unrelated to Mr. Trezza or the JRD investigation, the IRS notified Tenzer and his wife that due to their continued failure to respond to repeated inquiries, their accounts had been referred to enforcement action. The letter noted that Tenzer could still avoid enforcement action if he filed all delinquent returns and paid all outstanding taxes within ten days or if be immediately contacted the IRS by telephone.

Following receipt of this letter, Myron Weinberg, Esq., a law partner of Steven Solomon, called the IRS to pledge that the returns would soon be filed and requested additional time to do so. The IRS granted a series of extensions, through January 31, 1992. On February 10, 1992, Mr. Tenzer filed his tax returns for 1986, 1987, 1988, and 1989. The truthfulness of these returns was not questioned by the IRS at the time and they were "cleared for assessment." The returns were not accompanied with payment for his tax liabilities. Despite filing the returns, Mr. Tenzer failed to make any estimated tax payments throughout the year and thus did not remain current on his 1992 accruing taxes.

In September of 1992, Revenue Officer Elizabeth Kishlansky was assigned to collect the tax deficiency resulting from the returns as filed. On October 15, 1992, Revenue Officer Kishlansky met with Attorney Weinberg regarding the Tenzer matter. Weinberg advised Kishlansky that Tenzer was unable to

make full payment. but instead wanted to enter into a Installment Agreement with the IRS whereby he would be allowed to make full payment to the IRS over time. Revenue Officer Kishlansky informed Weinberg that Tenzer would only be given 30 days, until November 16, 1992, to resolve the collection situation. Kishlansky also informed Weinberg that Tenzer would have to submit a financial statement to evaluate this proposed Installment Agreement, and if the situation was not resolved by that time, the IRS would take enforcement action by levy, seizure and/or administrative action.

On October 16, 1992, Revenue Officer Kishlansky filed liens in New York County and Nassau County to protect the IRS' interest. On October 22, 1992, Kishlansky learned that Tenzer had not filed his 1990 or 1991 tax returns. She then "demanded" that those returns be filed. (GX C; Tr. 446.) This was a "solicitation" of the 1990 return, which is the subject of Count Four of the Information. The effect of this is discussed below.

On November 13, 1992, Tenzer filed his tax returns for the years 1990 and 1991.

On January 8, 1993, Ms. Kishlansky attended a meeting with Tenzer's tax counsel Myron Weinberg, Steven Solomon, and newcomer Ernest Honecker, an attorney who formerly was employed with the IRS in the Chief Counsel's office. Mr. Honecker testified, and I find, that he asked Ms. Kishlansky at the start of the meeting for assurances that Mr. Tenzer's voluntary disclosure was being handled as a civil matter. Kishlansky assured Honecker that it was a civil matter and that she was there only for collection. Revenue Officer Kishlansky was informed that rather than enter into an Installment Agreement, Mr. Tenzer wished to submit an Offer in Compromise. Kishlansky advised the representatives that if Tenzer wanted an Offer in Compromise to be considered by the IRS, he would have to start becoming current on accruing taxes and make all required current estimated tax payments. Tenzer's representatives indicated that the Offer would be approximately $250,000. Because a financial statement submitted at that time indicated that Tenzer had substantial assets and significant earnings potential, Kishlansky estimated that a reasonable Offer would be closer to $600,000.

After the meeting, but on that same day, Kishlansky called Weinberg and demanded that Tenzer sell several assets and begin making monthly payments of $7,000 towards his tax liability. No such payments were never made by Mr. Tenzer.

In February, 1993, Tenzer submitted an Offer in Compromise to Revenue Officer Kishlansky, which covered the tax years 1986 through 1991. This document was prepared by Tenzer's team of lawyers led by IRS alumnus Honecker, pursuant to a practice commonly followed by persons who owe large amounts of unpaid income taxes. Kishlansky reviewed the Offer, and advised Mr. Honecker that the Offer would most likely be rejected due to its failure to take into consideration Tenzer's future earning potential and his ability to liquidate assets to generate available cash to pay the IRS, and also that the Offer failed to include 1992. However, Ms. Kishlansky determined that the Offer was not facially inadequate or made in bad faith, and forwarded the Offer to a service center in Maine for processing and review.

In early April of 1993, attorney Honecker learned that the Offer in Compromise had been rejected. The Offer was rejected according to Honecker because of the Service's failure to discount Tenzer's non-liquid assets to their "forced sale" value. With news of the Offer's rejection, Honecker informed Kishlansky that he would be re-submitting the Offer, with whatever amendments were necessary to reflect Mr. Tenzer's current financial status.

Shortly after April 22, 1993, after having discussions with her Group Manager, Revenue Officer Kishlansky transferred the collections case to the Brooklyn office of the IRS, because Tenzer and his assets upon which to levy were located in Long Island. There the file became dormant.

The records of JRD called for in the subpoena issued in 1991 were produced in April, 1993. Special Agent Anthony Trezza of the Internal Revenue Service testified, and I find, that about May 14, 1993 he and others working with him found documents among records produced by the Margolin firm which supported an inference that Mr. Tenzer, "may have been a party to back-dating some [tax related corporate] documents" involved in the JRD investigation. This was the first occasion when Agent Trezza had reason to believe that Mr. Tenzer may have engaged in

criminal conduct, essentially as an aider and abettor of tax evasion by JRD or its principals. Mr. Trezza, almost immediately thereafter, discussed his conclusions with AUSA Dunne of this District, who in turn informed Mr. William Wachtel, who was then representing the Margolin firm, that Mr. Tenzer along with another Margolin partner, was now a "subject" of a criminal investigation in connection with JRD. (Transcript 8.) Mr. Wachtel was not affiliated with the Solomon, Weinberg, Honecker group of lawyers who were dealing with the civil tax matter. Apparently his representation of Mr. Tenzer began in connection with Tenzer's status as a JRD subject.

Mr. Trezza testified that probably around June of 1993, he, or Special Agent Walter Gross, with whom he was working on the matter, obtained from a computer terminal, a transcript of Mr. Tenzer's account as to his personal taxes. At the time the transcript was obtained, the witness Trezza and his fellow agents regarded Tenzer only as a subject for assisting JRD or its principals in committing fraud as to JRD's tax obligations or those of its principals and affiliates. He sought the transcript "in order to get a tax Grand Jury approved" through the Department of Justice to consider this aiding and abetting charge. Special Agent Trezza testified that the IR.S required that tax background on the individual be obtained and submitted with any request to enlarge an existing tax Grand Jury. Mr. Trezza explained (Transcript, 14), "where it is an accountant aiding and assisting somebody else we always request transcripts, because the attorneys that review our work want to see the IRS file on it." He testified that it was "required that when we submit the information pertaining to any individual tax crime, even if it doesn't pertain to his own taxes, we always have to get a transcript of their filing record." Thus, Mr. Trezza ascertained that Mr. Tenzer had been a late filer for the years included in this prosecution, but that his returns had been filed, and desultory efforts to collect the taxes due had begun.

In June 1993, Mr. Trezza spoke to the Civil Collection Officer. Finding from that discussion that there was a file showing collection efforts, he asked for that file. The civil file was requested from the Collections Office on June 14, 1993 by Special Agent Gross. Special Agent Gross notified the collections

officer not to take any action on the account until a decision was made to put a "914" freeze[2] on the account. On June 23, Gross notified the collections officer that steps were being taken to put such a freeze on the collection efforts. Collection remains frozen to this day.

On June 24, 1993, the office of the United States Attorney requested from IRS District Counsel authorization to expand the Title 26 Grand Jury investigation of JRD to include James Tenzer as a named subject in his role in the preparation of JRD's tax returns. By letter dated July 8, 1993 the United States Attorney received authorization to investigate Tenzer for Title 26 offenses, without limit. The following day, July 9, 1993, Special Agents Trezza and Gross notified Myron Weinberg that Tenzer was now a subject of a Grand Jury investigation into his personal tax matters.

On September 28, 1994, Special Agents Trezza and Gross attended a pre-referral conference with James Biaggi, an attorney with the IRS' District Counsel's Office. As a result of that meeting, by a memorandum authored by Robert B. Marino, Assistant District Counsel, the IRS concluded that it would be appropriate for the United States Attorney's Office to proceed with a prosecution for failure to timely file tax returns as Tenzer did not meet the criteria for the Voluntary Disclosure Policy.

As will be understood, this was unusual. Most prosecutions for failure to file originate with the IRS and are sent to the Department of Justice which may decline. In this case the request to proceed against Tenzer as a non-filer originated with the DOJ, or more correctly, the local United States Attorney's Office, after it had exhausted its ability to make a case against Tenzer for his likely complicity in the JRD tax fraud. Am understandable desire to make some charge of some sort stick against Tenzer appears to have influenced subsequent consideration of his case in light of the Voluntary Disclosure Policy.

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[2] A "914" freeze is a code, based upon an obsolete form, reflected on the taxpayer's transcript, that signifies that the taxpayer is under criminal investigation. When a 914 is issued on a particular taxpayer's case, all civil collection and assessment efforts stop. (Transcript 526-529.)

The Special Agent's Report dated November 15, 1994, recommending that charges be brought for failure to timely file, was forwarded by the IRS to the Department of Justice. Thereafter, Tenzer's counsel attended a meeting at the DOJ where they argued that Tenzer should not be prosecuted because he fell within the provision of the IRS' Voluntary Disclosure Policy. Rejecting this contention, the DOJ subsequently authorized this prosecution of Tenzer for failure to timely file tax returns for the years 1987-1990, as four separate counts.

THE VOLUNTARY DISCLOSURE PROGRAM

Since about 1961, the IRS has had a publicly announced Policy, changed from time to time, which is to encourage taxpayers who have failed to file returns, to do so and in effect come, or be brought back into the system for past and future returns. There are many such non-filers, some of whom are entitled to refunds, and some of whom fail to file for a variety of reasons which do not include the intent to evade income taxes. The goal of the agency is not to procure misdemeanor convictions against these non-filers as a general deterrent to others, as authorized by Congress, but rather, to collect their taxes and welcome them back to the largest voluntary tax assessment system in the world.

To lure these non-filers into a state of grace with their taxes, offers and promises were made from time to time with much public fanfare, couched, unfortunately, in language not always precise as a penal statute, and written without much consideration of possible application of the rule of the Caceres footnote.

While the applicability and scope of the Voluntary Disclosure Policy are a matter of law for this Court to determine, there is some dispute as to what the actual publicly stated Policy of the IRS was at the relevant times in this case, and how it was imparted to the public.[3] In this regard, the testimony of Assistant District Counsel Robert Marino and former Acting Assistant

[3]There is no evidence that Tenzer ever heard of the Policy at the time he acted. Reliance, however, is not an element of the defense here, which implicates the equal protection element implied in the Due Process Clause of the Fifth Amendment.

Attorney General James Bruton during the evidentiary hearing is relevant.

Mr. Robert Marino testified that the Voluntary Disclosure Policy (the "Policy") governs how the IRS reviews its cases when considering a referral for prosecution, and that it is not intended to create any substantive rights,[4] Marino testified that it was the IRS' view that Tenzer did not make a true voluntary disclosure, and that even if he had, prosecution was warranted due to his egregious circumstances. (Transcript, 170.) We note that there is no exception stated in the Policy for egregious circumstances, whatever that means. Marino testified that the voluntary disclosure did not apply to Tenzer because (1) it was "triggered" by Mr. Trezzar's service of the JRD subpoena on Mr. Tenzer; (2) that he did not believe that the Offer and Compromise was legitimate; and (3) that "[t]he amount of money involved; the amount of years involved; no withholding paid; taxpayers sophistication; being an attorney: All of these matters, I think, make this an egregious case." (Transcript, 171.) This Court agrees that the misconduct of Tenzer is egregious by any definition of the word; that is besides the point under the IRS Policy.

The Internal Revenue Manual ("I.R.M.") at Section 342.142 (promulgated April 5, 1993) set forth the Service's Voluntary Disclosure Policy as effective when this prosecution commenced. Subsection (3) lays out the conditions under which a non-filer may qualify for relief under the Voluntary Disclosure Policy. The person must have:

> (1) informed the Service that he or she has not filed re for one or more taxable years;
>
> (2) had only legal-source income;
>
> (3) made the disclosure prior to being contacted by the Service notifying the taxpayer or his/her representative by letter, the phone or personal visit that the taxpayer is under criminal investigation;

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[4] In light of the Caceres case this intent is irrelevant.

(4) either filed true and correct tax returns or cooperated with the Service in ascertaining his/her correct tax liability; and

(5) either made full payment of the amounts due or in those situations where the taxpayer was unable to make full payment, made a bona fide arrangement to pay.

(Emphasis added)

Subsection (5) provides that the IRS' voluntary disclosure practice creates no substantive or procedural rights for taxpayers, but rather is a matter of internal IRS practice, provided solely for guidance to IRS personnel. The validity of this reservation is challenged in light of Caceres, discussed below.

The Government's position is that the proper Voluntary Disclosure Policy to apply is not that which was in force when the decision was made to prosecute, in clear derogation of the express terms of the Policy, but rather that Policy which was in effect in February of 1992, when Tenzer's tax re were filed. This Court rejects this argument. The Policy in effect when the decision to prosecute is made is the Policy which under Caceres must control the decision making.

The critical distinction between the Policy when the returns were filed, and the Policy as effective at the initiation of this prosecution is the definition of when a Voluntary Disclosure is timely made. Section 342.14, as effective when the defendant was initially contacted by the IRS regarding his non-filing status, required the disclosure to be made prior to the taxpayer's awareness of an IRS inquiry,[5] Unlike the April 5, 1993 "Policy", the provision did not limit itself to "criminal" inquiries. Specifically, the Voluntary Disclosure Policy as effective in February, 1992, considered a disclosure to be timely when it is received before:

(a) The IRS has initiated an inquiry that is likely to lead to

[5] A computer generated inquiry is probably not an inquiry for these purposes. However, as noted, the pre-1993 Policy should not apply to the case. As discussed infra in text, Tenzer's case is also within the prior Policy.

> the taxpayer, and the taxpayer is reasonably thought to be aware of that investigative activity; or
>
> (b) some event known to the taxpayer occurred, which event is likely to cause an audit into the taxpayer's liabilities, e.g., a newspaper article highlighting commercial bribery in a particular industry or corruption in a government office.

The Policy as in effect during 1993 was first announced in an IRS press release issued in December of 1992 by then IRS Commissioner Shirley Peterson. In April of 1993, the IRS Manual was updated to conform to the Policy announced in the press release. During the evidentiary hearing, Robert Marino attempted to minimize the importance of this change by suggesting that the December 1992 press release did not accurately reflect Ms. Peterson's intent, and that what she really meant was only that out of 147 million returns that are filed in a year only 2,500 are actually prosecuted. "[W]hat [Peterson is] really saying, as a practical matter, is that most people who don't file returns probably don't get prosecuted, and I think that's what she was saying there." (Transcript, 134.) While it is not uncommon for press releases to reflect inaccurately the drafter's intent, any notion that the press release quoted infra, was inaccurate is belied by the fact that in April of 1993 the IRS Manual was updated to reflect the change.

In 1995 the IRS switched back to the Policy in effect prior to April 5. 1993 and amended its Manual provisions accordingly.[6]

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[6] It is interesting but probably irrelevant that the Tax Division of the Department of Justice, which claims to have the final determination of whether to prosecute a Grand Jury matter, has published policies on voluntary disclosures that mirror the IRS' Policy prior to the December 1992 revision. When the IRS modified it's Policy in 1992 the Tax Division did not change its policy to reflect that new IRS definition of a timely disclosure. (Transcript, 161.) However, James Bruton, who in his former role as Deputy Assistant Attorney General was responsible for overseeing all criminal tax cases in the United States, testified,

The Government argues that the service upon Mr. Tenzer of the subpoena directed at JRD documents was enough to put him on inquiry of investigative activity into his own return and make any subsequent disclosures untimely. However, under either standard, pre or post 1993, this Court concludes that the Voluntary Disclosure Policy standards were met by Mr. Tenzer. Under the "Peterson" Policy, Tenzer filed prior to being notified of a pending "criminal" investigation into his personal taxes. And under the prior and now current Policy, Tenzer began good faith efforts through Attorney Weinberg to file his returns and become current on his obligations prior to a sufficient "triggering" to alert him that he was under investigation.

An October 5, 1994 memorandum to Peter Persampieri, Manager of CID[7] Group C-21, from District Counsel Manhattan signed by Robert B. Marino, Assistant District Counsel which was examined by this Court as *in camera* exhibit[8], summarized the tax filing history of Mr. Tenzer noting that he had filed his 1987, 1988 and 1989 tax returns delinquently on February 10, 1992 and his 1990 return was filed on November 13, 1992. "Tenzer has a long history of delinquent filing. Since 1976 he has filed only one timely return." The report notices that on November 13, 1992, when Tenzer filed his 1990 return upon the request of a revenue officer "he was aware that he was a potential target of the JRD investigation." This report continues:

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and I find, that the IRS is the interpreting agency and the Department of Justice as a matter of Policy simply abides by the IRS' determination. (Transcript, 275.) So, as a practical matter, the Department of Justice, while having final determination as to whether any matter will be prosecuted or not, will not seek prosecution in a tax matter without IRS concurrence that it should do so.

[7] Criminal Investigative Division of the Internal Revenue Service. Special Agents Trezza and Gross were employed with the CID, while Revenue Officer Kishlansky was in the Civil Division.

[8] It is doubtful whether the findings in the Memorandum are privileged at this point of time. To rule on privilege the Court must examine the document, following which it is difficult to un-ring the bell. Even if the reasoning is privileged, or the document itself cannot be considered, this is academic as the facts themselves can be inferred from the testimony and other evidence in the case.

> The Internal Revenue Manual at Section 342.142 (promulgated April 5, 1993) sets forth the Service's voluntary disclosure Policy regarding a tax payer who come [sic] forward to report his/her tax crime. According to Sub-section (2), a voluntary disclosure occurs when a taxpayer's communication is truthful, timely, complete, and he/she shows a willingness to cooperate. Subsection (3) lays out the condition under which a non-filer may qualify for relief under the voluntary disclosure Policy".

The memorandum then listed the five elements required to be satisfied and concluded that elements 1, 2 and 4 were in fact satisfied by Mr. Tenzer in that he had informed the service he had not filed for one or more years, had only legal-source income and filed correct tax returns. Accordingly, Mr. Marino concluded that the only issues to be addressed were whether Mr. Tenzer had met elements 3 and 5. The attorney concluded in his authoritative interpretation of IRS Policy that the 1990 return was not within the Voluntary Disclosure Policy because the tax payer had been "contacted by CID prior to filing."

As noted earlier, this conclusion is not supported by the facts. There was nothing in the service of the subpoena for JRD papers which would reasonably be regarded as a triggering event or contact by CID which notified Tenzer he was under criminal investigation for failure to file his own returns. Such contact was at most notice with regard to criminality in connection with his activities as accountant for JRD and its affiliates.

Recognizing that Mr. Tenzer, "may meet the literal meaning of the third element" counsel rendered the opinion that "treating Tenzer's filing as a timely disclosure would pervert application of the Service's Voluntary Disclosure Policy. Counsel concluded that in light of Tenzer's involvement with JRD, his expertise in taxation and the fact that he may have assisted in JRD's tax evasion scheme:

> [I]t is reasonable to conclude that Tenzer's notification of the JRD investigation was adequate to alert him that he was a potential target of a

> criminal investigation thereby prompting his delinquent filings. As such it is this Office's opinion that Tenzer did not make timely disclosure.

Counsel also took the position with respect to the amendment of Section 342.142 that the prior provision should be applied to determine whether Tenzer made a timely disclosure. Under the previous version, counsel argued, disclosure was timely if it was received before the Service had initiated an inquiry that was likely to lead to the taxpayer and the taxpayer was reasonably thought to be aware of the investigative activity, or some event known by the taxpayer occurred which was likely to cause an audit into the taxpayer's liabilities. However, as noted above, this limitation was not applicable after December 1992 when the voluntary disclosure program was loosened so as to permit a taxpayer to qualify if he/she made disclosure prior to CID contact. The Assistant District Counsel also concluded that the application of the Voluntary Disclosure Policy was unwarranted because of Tenzer's refusal to pay the tax that was due and because there were no bona fide arrangements to pay. The opinion remarked upon Tenzer's "extravagant lifestyle, spending substantially all of his large income on expensive cars and homes."

The Policy then in effect does not allow for these conclusions to affect its administration. Insofar as concerns the inadequacy or claimed bad faith in the offer to Compromise (1.3 Million in taxes for $250,000,) this Court concludes that the filing of the Offer (the work of experienced IRS alumnus Honecker and two other tax specialists) laughable as it may be, was not sufficient to disqualify Tenzer form the benefits of Voluntary Disclosure. Tenzer acted on the advice of experienced counsel, intending fully to comply with and get the benefit of the Policy. The attorneys were following their customary practice, in effect opening negotiations with a low-ball offer. The Service could have and did reject the Offer, and was free to have assessed, liened, restrained, and otherwise collected the tax from Tenzer at any time.

Having concluded that Tenzer met the requirements of the IRS' Voluntary Disclosure Policy, this Court must now determine the consequences of the IRS's failure to follow its own Policy.

The doctrine expressed in footnote 14 of Caceres has its origins well prior to that case. As our Court of Appeals explained in Montilla v. I.N.S., 926 F.2d 162, 166 (2nd Cir.1991), the seeds of the doctrine "are found in the long settled principal that rules promulgated by a federal agency, which regulate the rights and interests of others, are controlling upon the agency." Citing Columbia Broadcasting System, Inc. v. United States, 316 U.S. 407, 422 (1942) (agency regulations on which individuals are entitled to rely bind agency.) In Smith v. Resor, 406 F.2d 141, 145 (2nd Cir. 1969), our Court of Appeals recognized that "[a]lthough the courts have declined to review the merits of decisions made within the area of discretion delegated to administrative agencies they have insisted that where the agencies have laid down their own procedures and regulations, those procedures and regulations cannot be ignored by the agencies themselves even where discretionary decisions are involved." In Montilla v. I.N.S., our Court of Appeals concluded that the rule requiring an agency to abide by its own policies and regulations as being "premised on fundamental notions of fair play underlying the concept of due process," and that "[i]ts ambit is not limited to rules attaining the status of formal regulations." 926 F.2d at 167.

The Government argues that the IRS' Voluntary Disclosure Policy governs only "internal agency procedures" and thus affords Mr. Tenzer no Due Process rights. As the evidentiary hearing made clear however, the Voluntary Disclosure Policy was disseminated to the public through grandiloquent press releases, and materials made available at IRS offices which tend to omit the fine print. For example, Defendant's Exhibit D is IRS publication 1715 (Rev. 7-93) entitled "It's Never Too Late!" The brochure explains the benefits of the Voluntary Disclosure Policy. Under the subheading "Will I go to jail?" it provides:

> Our long-standing practice has been not to recommend criminal prosecution of individuals for failure to file tax returns -provided they voluntarily file or make arrangements to file

before being notified that they are under criminal investigation. (Emphasis added)

* * *

... We want to get people back into the system, not prosecute ordinary people who made a mistake. However, we will continue to investigate flagrant cases involving criminal violations of the tax laws.

Under the totality of the circumstances, any reservation by which the Government may nevertheless prosecute individuals regardless of compliance with the Policy must be ineffective if the Caceres doctrine is to be given any weight. Indeed it is fair to say that Tenzer's case is unique in the regular day to day administration of the Policy.

The Government argues that even were the Voluntary Disclosure Policy applicable to Mr. Tenzer, as this Court concludes that it is, the Information should not be dismissed because Tenzer has failed to demonstrate that he relied on the Policy or suffered any prejudice because of the IRS' noncompliance with the Policy. There can be little doubt however that Tenzer's experienced counsel were familiar with the Policy and were advising him in light thereof. Tenzer's counsel informed Revenue Officer Kishlansky that it was Tenzer's intent to make such a Voluntary Disclosure, and she informed them that the case was being handled as a civil and not a criminal matter. The same notions of fairness which require an agency to abide by its own regulations require that Tenzer, who met the requirements of the Policy, be afforded its benefits even were he not relying on it. Insofar as concerns prejudice, we doubt this needs to be proved to rely on the Caceres doctrine. If Tenzer is being prosecuted because of a failure to apply the Policy because of mistake of fact or law, he is prejudiced. If, as appears highly likely, the Policy would have been applied to him but for the justifiable conclusion on the part of the authorities that he lived an extravagant lifestyle and probably aided and abetted JRD in criminality, the case represents a denial of Constitutionally protected due process.

An issue that arose during the evidentiary hearing was whether Count Four of the Information against Mr. Tenzer should

also be dismissed because his prosecution violates the Non-Solicitation Policy of the IRS. Section (31)3600 of the Internal Revenue Manual entitled "Solicitation of Returns" provides that prosecution should not be recommended when a return is solicited and received prior to the taxpayer being contacted by the Criminal Investigation Division. Because the Non-Solicitation Policy expressly excludes "Computer generated inquiries" from solicitations, and because the returns for the years 1987, 1988 and 1989 were filed in response to computer generated notices the solicitation policy would not seem to apply to those years. However, the 1990 return, which was personally demanded by the Revenue Officer, would seem to fit squarely within the Non-Solicitation Policy and should not have been prosecuted. This presents an additional ground to bar prosecution under Count Four of the Information.

The Government argues that the Non-Solicitation Policy is not applicable because (1) the returns were only demanded so that Tenzer's Offer in Compromise could be processed, and (2) Tenzer did not rely upon the Policy. Both arguments are without merit. The Government argues that in essence the 1990 return was not solicited because it would not have been demanded by the Revenue Officer had it not been for Tenzer's desire to file an Offer in Compromise. The rights protected by the Non-Solicitation Policy however are not concerned with *why* a return was solicited, but only that it was solicited. The Non-Solicitation Policy is premised upon the concerns protected by the Fifth Amendment protections against self incrimination. The concerns protected by the Non-Solicitation Policy involve situations where an individual has not filed a return, the IRS subsequently demands the return, the return is filed by the individual, and then the IRS turns around and prosecutes the individual based upon the information supplied in the return. Such a situation is no less egregious when the taxpayer is unaware of the Non-Solicitation Policy and does not rely upon it in filing the return.

As a final matter, Mr. Tenzer moves to dismiss Count One of the Information as it relates to 1987 on the basis that prosecution for that year is time barred. The uncontested evidence indicates the following: Tenzer's 1987 tax return was originally

due on April 15, 1988. He sought and received two extensions for filing, extending his filing date through October 17, 1989. Accordingly, absent a tolling agreement, the statute of limitations for the 1987 tax return would have return on October 17, 1994, six years from his extended date of filing. Tenzer however entered into a series of tolling agreements with the Government and agreed to toll the limitations periods for all charges that could have been brought on August 31, 1994, until and including November 30, 1995, the date on which the Information was filed. Title 26 of the United States Code at Section 6513(a) provides a uniform expiration date by providing that returns filed before the deadline date are to be considered as having been filed on the deadline date. In United States v. Habig, 390 U.S. 222 (1968), the United States Supreme Court concluded that the provision is limited to cases in which the return is filed or payment is made prior to the statutory deadline. As such the provision is inapplicable to this case and Count One was timely brought.

Accordingly, the defendant's motion is granted and the Information is dismissed as to all Counts on the ground that defendant complied with and is protected by the Internal Revenue Service's Voluntary Disclosure Policy. Count Four relating to the tax year 1990 must also be dismissed for the independent reason that the return was actively solicited in violation of the IRS' published Non-Solicitation Policy.

SO ORDERED.

Dated: September 10, 1996
White Plains, New York

CHARLES L. BRIEANT
Charles L. Brieant
United States District Judge

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1824 – August Term. 1996

(Argued: June 26, 1997 Decided: September 19, 1997)

Docket No. 96-1653

UNITED SATES OF AMERICA,

Appellant,

– V. –

JAMES TENZER,

Defendant-Appellee.

Before:

MINER and MCLAUGHLIN, *Circuit Judges,*

and NICKERSON, *District Judge.* *

Appeal from an order of the United States District Court for the Southern District of New York (Brieant, J.) dismissing an Information charging defendant with willful

failure to file income tax returns, the court having found that the IRS had violated its own policy by recommending criminal prosecution of one who voluntarily disclosed his failure to file and who thereafter filed the delinquent returns and made an offer in compromise his tax liability.

Reversed and remanded.

IRA M. FEINBERG, Assistant United States Attorney for the Southern District of New York, New York, NY (Mary Jo White, United States Attorney for the Southern District of New York, Cynthia Keefe Dunne, Peter G. Neiman, Assistant United States Attorneys, of counsel), *for Appellant.*

WILLIAM B. WACHTEL, Gold & Wachtel, LLP, New York, NY (Elliot Silverman, Gold & Watchel, LLP, New York, NY, Mortimer M. Caplin, Caplin & Drysdale, Chartered, Washington, D.C., of counsel), *for Defendant-Appellee.*

(Michael R. Young, Stacey E. Paradise, Willkie Farr & Gallagher, New York, NY, Richard I. Miller, General Counsel, American Institute of Certified Public Accountants, New York, NY, of counsel), *for Amicus Curiae American Institute of Certified Public Accountants.*

(Robert S. Fink, Kostelanetz & Fink LLP, New York, NY, of counsel), *for Amici Curiae New York County Lawyers' Association and New York*

State Society of Certified Public Accountants.

MINER, *Circuit Judge:*

Appeal from an order of the United States District Court for the Southern District of New York (Brieant, J.) dismissing a four-count Information charging defendant with willful failure to file income tax returns, in violation of 26 U.S.C. § 7203. The court found that the IRS had violated its own policy by recommending criminal prosecution of one who voluntarily disclosed his failure to file and who thereafter filed the delinquent returns and made an offer in compromise of his tax liability. The district court found that this policy violation constituted a denial of due process.

For the reasons that follow, we reverse and remand to the district court.

BACKGROUND

Defendant-appellee James Tenzer is an experienced tax attorney and accountant. At all relevant times, he was a principal of the Long Island, New York, accounting firm of Margolin Winer & Evens ("MWE") and head of its tax department. It is undisputed that Tenzer failed to timely file income tax returns for the years 1987 through 1990, or pay any taxes for those years.

During 1988, 1989 and 1990, the IRS sent Tenzer computer-generated notices regarding his failure to make the required tax filings. Tenzer repeatedly ignored these notices. In March of 1991, Tenzer retained a tax attorney, Steven Solomon, to assist him in filing his returns but did not immediately contact the IRS or file any returns. Tenzer

continued to receive computer-generated notices of his failure to file from the IRS. By letter dated October 7, 1991, the IRS notified Tenzer and his wife that, due to their failure to respond, their accounts had been referred for "enforcement action," meaning civil or administrative enforcement. Tenzer was warned that enforcement action could be avoided by calling the IRS immediately or filing all delinquent returns within ten days.

Following receipt of the October 7 letter, Solomon's partner, Myron Weinberg, twice called the IRS to request an extension of time to file Tenzer's returns for 1986 through 1989. He first requested an extension until November 18, 1991, and, November 15, 1991, he requested an additional extension until December 14, 1991. However, Tenzer's returns were not filed by December 14, 1991. The IRS subsequently designated Tenzer's case for investigation and enforcement.

On February 10, 1992, Tenzer filed his returns for 1986 through 1989. However, no payment accompanied these returns, nor did Tenzer at that time file his then-delinquent 1990 return.

I. Civil Collection Efforts

In September of 1992, collection of Tenzer's tax deficiency was assigned to Revenue Officer Elizabeth Kishlansky, a civil collection officer. On October 15, 1992, she met with Weinberg at Solomon's office and demanded full payment of the taxes. Weinberg stated that Tenzer was unable to pay in full and wanted to enter into an installment agreement.

On October 22, 1992, Kishlansky reviewed an IRS transcript of Tenzer's account and learned that Tenzer had not filed returns for 1990 and 1991. Kishlansky telephoned

Weinberg's office and left a message demanding that Tenzer file his 1990 and 1991 returns if he wanted the IRS to consider an installment agreement. Kishlansky and Weinberg spoke the next day. Kishlansky explained the IRS's policy of not agreeing to an installment plan with a taxpayer for any given year's tax liability when that taxpayer is delinquent in filing for other tax years. Kishlansky said that Tenzer must file his 1990 and 1991 returns by November 30, 1992 if he wanted to be considered for an installment agreement.

Tenzer filed his delinquent 1990 and 1991 returns on November 13, 1992. On January 8, 1993, after all the relevant returns had been filed, Kishlansky met with Weinberg, Solomon, and a new lawyer for Tenzer, Ernest Honecker, who formerly had been a high-ranking attorney with the IRS. According to the district court, Honecker asked Kishlansky at this meeting for assurances that Tenzer's voluntary disclosure was being handled as a civil matter, and was assured by Kishlansky that it was a civil matter and that she was there only for collection. At this meeting, Tenzer's attorneys first informed Kishlansky that Tenzer intended to make an "offer in compromise," that is, an offer of partial payment in settlement of Tenzer's outstanding tax liabilities instead of full payment over time through an installment agreement. Kishlansky advised the attorneys that the IRS would not consider such a compromise settlement unless Tenzer started to become current on accruing taxes and make all required estimated tax payments. She also advised that any offer would have to be substantial. Tenzer's attorneys indicated that the offer would be approximately $250,000. Kishlansky responded by estimating that, given Tenzer's assets and potential earnings, a reasonable offer would be in excess of $600,000. Following the meeting, and after reviewing a financial statement provided by Tenzer at the meeting, Kishlansky called Weinberg and demanded that

Tenzer divest himself of several assets and begin making monthly payments of $7,000 toward his tax liability. Tenzer never made any monthly payments.

By letter dated February 5, 1993, Honecker submitted on behalf of Tenzer a formal offer in compromise in the amount of $250,000. At that time, Tenzer's total tax liability was approximately $1.3 million. Enclosed with the offer was a $5,000 check payable to the IRS, which represented the first payment under the offer terms, with $245,000 to follow within 30 days of acceptance of the offer. The financial statement that accompanied the offer showed that Tenzer's equity in assets was $345,300. The IRS subsequently returned the check and rejected the offer as being "unprocessable" because it was below the minimum amount. The letter of rejection explained that "for offers based on inability to pay, you must generally offer an amount equal to or in excess of the amount shown as 'equity in assets' on your financial statement(s)."

On April 14, 1993, Honecker responded with a letter to the IRS arguing that the IRS should accept the offer. Honecker explained that, in arriving at the offer amount of $250,000, consideration had been given to the forced sale value of non-liquid items such as real estate and Tenzer's partnership interests. Quoting the IRS Manual, he urged that it was appropriate to use the forced sale value of assets in determining Tenzer's collection potential. Honecker also noted that he intended to resubmit the offer with an explanation attached to the financial statement of how he arrived at the forced sale value of certain assets. Additionally, because Tenzer had made estimated payments on his 1993 federal and state income taxes, Honecker wrote that some of Tenzer's liquid assets had declined in value and therefore a new financial statement would be prepared.

During these negotiations with the IRS, Tenzer failed to become current on his accruing tax liabilities. He paid no estimated taxes during 1992, and, although he timely filed his 1992 return, he failed to pay any of the $135,665 tax due for that year.

Kishlansky and her supervisor concluded that Tenzer was not attempting in good faith to pay his taxes, but rather was engaged in stalling tactics. In late April of 1993, Tenzer's file was transferred to the IRS's office in Brooklyn, the office for the region in which most of Tenzer's assets were located, for further collection. According to Honecker, Kishlansky informed him of the transfer and instructed him to forego resubmission of his offer until he had been contacted by a revenue officer from the Brooklyn office.

Honecker testified that although he had prepared the offer for resubmission, the Brooklyn office never contacted him. Instead, he was informed by a special agent, in late June or early July of 1993, that Tenzer was under criminal investigation by the IRS. Honecker allegedly asked the agent if the Brooklyn office had not contacted him because a freeze had been placed on the collection action in light of the criminal investigation, and the special agent answered in the affirmative. Apparently, the special agent had notified a civil collections officer earlier that month not to take any further action on Tenzer's case due to the pending freeze.

II. Criminal Investigation and Prosecution

In July of 1991, MWE was notified by one of Tenzer's clients, JRD Management Corp. ("JRD"), a real estate management firm, that JRD had been served with a grand jury subpoena seeking its records in a criminal tax investigation. On November 22, 1991, in connection with that investigation, MWE also was served with a grand jury subpoena requiring production of documents relating to JRD.

The government, believing that Tenzer might have been involved in some fraudulent activity, sought authorization to include him in its investigation of JRD. In June of 1993, while gathering information to support this request, government agents discovered that Tenzer himself had failed for years to timely file his tax returns. The U.S. Attorney's Office accordingly requested and received authorization from the IRS to investigate Tenzer both for his role in the JRD fraud case and for offenses relating to Tenzer's personal taxes, including failure to timely file. On June 23, 1993, the IRS placed the freeze on Tenzer's case, and, on July 9, 1993, Tenzer was notified that he was the subject of a criminal investigation into his personal returns.

On November 15, 1994, the IRS forwarded to the tax division of the Justice Department a recommendation that Tenzer be prosecuted. Tenzer's attorneys attended a meeting at the Justice Department in Washington, D.C. approximately two months later. They there argued that Tenzer should not be prosecuted because of his compliance with the voluntary disclosure policy. On March 27, 1995, the Justice Department authorized Tenzer's prosecution and, on November 30, 1995, Tenzer was charged in a four-count Information. The Information charged him with having unlawfully, willingly and knowingly failed to file income tax returns for 1987, 1988, 1989, and 1990.

On March 4, 1996, Tenzer filed a motion to dismiss the Information. He claimed that he had satisfied the requirements of the IRS's voluntary disclosure policy, and that the IRS--in recommending prosecution--had failed to follow its own policy, thereby violating his due process rights. In the alternative, Tenzer argued that the returns and any resulting evidence should be suppressed because they were produced in reliance upon the IRS's alleged promise of immunity from prosecution. Tenzer also argued that Count One, relating to his 1987 return, was barred by the statute of limitations.

The district court held a four-day evidentiary hearing in April of 1996. During that hearing, Tenzer first asserted that his prosecution for failing to file his 1990 return also was barred by the IRS's non-solicitation policy.

On September 10, 1996, the district court granted Tenzer's motion and ordered the Information dismissed on the ground that Tenzer had satisfied the IRS's voluntary disclosure policy and therefore was immune from prosecution. The district court also determined that Tenzer's 1990 return had been solicited by Kishlansky and that this provided an independent basis for dismissal of Count Four of the Information, which related to the 1990 tax year. This appeal followed.

DISCUSSION

I. Tenzer's Compliance with the Voluntary Disclosure Policy

The government argues that the district court erred in determining that Tenzer satisfied the IRS's voluntary disclosure policy. We agree.[1]

A. The Voluntary Disclosure Policy

The IRS's voluntary disclosure policy has been in existence, in one form or another, since 1952. Prior to 1952, the Treasury Department applied a voluntary disclosure policy which "presupposed, at the very least, that a delinquent taxpayer would make a full 'clean breast of things.' " *Shotwell Mfg. Co. v. United States*, 371 U.S. 341, 349, 83 S.Ct. 448, 454, 9 L.Ed.2d 357 (1963) (*quoting United States v. Shotwell Mfg. Co.*, 355 U.S. 233, 235, 78 S.Ct. 245, 247, 2 L.Ed.2d 234 (1957)). The Supreme Court described this earlier

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[1] The government also disputes the district court's determination that the IRS's decision to prosecute Tenzer violated his due process rights. Because we conclude that the district court erred in finding that Tenzer complied with the voluntary disclosure policy, we find it unnecessary to reach this issue.

version of the voluntary disclosure policy as an "offer of immunity." Id. at 350, 83 S.Ct. at 454. On January 10, 1952, the Treasury Department announced that it was abandoning its former policy. The Department explained that "[i]t is the policy of the Treasury Department to recommend criminal prosecution in every case where the facts and circumstances warrant that action." Treas. Decl. S-2930 (Jan. 10, 1952). The IRS issued a statement in 1961 reaffirming the 1952 position, stating that "even true voluntary disclosure of a willful violation will not, of itself, guarantee prosecution immunity. At the same time, the Service will carefully consider and weigh it, along with all other facts and circumstances, in deciding whether or not to recommend prosecution." I.R.S. News Release IR- 432 (Dec. 13, 1961). This policy was written into the Internal Revenue Manual ("IRM") in 1973. The relevant IRM provision stated that a voluntary disclosure may be "significant" in the IRS's decision whether to recommend prosecution, but "does not necessarily preclude prosecution." IRM § P-9-2 (Jan. 19, 1973).

The voluntary disclosure policy was amended several times over the years. However, all versions had in common the requirement that, in order to be eligible for the benefits of the policy, the taxpayer must either pay or make bona fide arrangements to pay the applicable taxes and penalties. *See, e.g.*, IRM § 342.142(3)(e) (Apr. 5, 1993) (requiring that the taxpayer have "[e]ither made full payment of the amounts due or in those situations where the taxpayer was unable to make full payment, made bona fide arrangements to pay"); IRS Chief Counsel's Directives Manual ("CCDM") §(31)330(4)(d) (Dec. 12, 1991) ("The taxpayer must make

bona fide arrangements to pay the applicable taxes and penalties to the extent of the taxpayer's actual ability to pay.").

B. Tenzer's Compliance

The parties vigorously dispute which version of the voluntary disclosure policy applies. We need not decide this question, nor the related question of whether Tenzer's disclosure was timely, because we find that Tenzer failed either to pay his taxes or to make bona fide arrangements to pay. Thus, irrespective of which version of the policy is applicable, Tenzer has not satisfied the voluntary disclosure policy.

There is no question that Tenzer failed to pay any of his tax liability prior to his criminal investigation. Rather, at issue is whether Tenzer's offer in compromise satisfied the requirement that he make bona fide arrangements to pay his tax liability.

The district court stated that:

> Insofar as concerns the inadequacy or claimed bad faith in the offer to Compromise (1.3 Million in taxes for $250,000 [ ])[,] this Court concludes that the filing of the Offer (the work of experienced IRS alumnus Honecker and two other tax specialists)[,] laughable as it may be, was not sufficient to disqualify Tenzer f[ro]m the benefits of Voluntary Disclosure. Tenzer acted on the advice of experienced counsel, intending fully to comply with and get the benefit of the Policy.

United States v. Tenzer, 950 F.Supp. 554, 562 (S.D.N.Y.1996). We think that the district court erred in finding that the offer alone was sufficient to meet the requirement that there be a bona fide arrangement to pay. An "arrangement to pay" may be a great variety of things, e.g., an installation payment agreement, a promise to pay on

a specific date, or an offer of a lump-sum payment in compromise. However, under the express language of the policy, the "bona fide arrangement" must have been "made" for the policy to apply. As with statutory interpretation, we interpret this agency policy in accordance with the plain meaning of its words, unless such a reading "will produce a result demonstrably at odds with the intentions of its drafters." *United States v. Reyes*, 116 F.3d 67, 71 (2d Cir. 1997) (quotation omitted) (referring to statutory construction). Under its common usage, an arrangement is "made" when it is "brought about" or "caused to exist." *See Webster's Third New International Dictionary of the English Language Unabridged 1363 (1981)*. Thus, the plain language of the policy contemplates that an agreement on a course of payment must exist between the IRS and the taxpayer. The policy is not satisfied by mere offers to make payment; rather, it requires a specific plan, accepted by the IRS, to satisfy outstanding tax liability. Given the plain meaning of the voluntary disclosure policy, Tenzer's rejected offer in compromise clearly is not a bona fide arrangement to pay.

Likewise, it is irrelevant that a taxpayer intends to eventually reach an agreement. The policy does not provide for best intentions, but rather requires that an arrangement be "made". Hence, the district court's apparent reliance upon Tenzer's alleged good intentions was erroneous.

While the burden of making a bona fide arrangement rests principally on the taxpayer, we note that the government is obligated to negotiate in good faith with the taxpayer toward the end of achieving an arrangement to pay. An arrangement can only be made if the IRS agrees to it, but the IRS may not withhold its assent capriciously or in bad faith. The IRS must afford a taxpayer who has acted in reliance upon the voluntary disclosure policy a reasonable opportunity to satisfy all of the conditions of that policy, including a

payment plan. If the parties cannot agree within a reasonable time on a suitable arrangement for payment, then the IRS is justified in refusing to treat that taxpayer as a voluntary discloser.

In the instant case, it is clear that Tenzer was given ample opportunity, including a reasonable length of time, to comply with the voluntary disclosure policy, yet repeatedly failed to do so. At the meeting on January 8, 1993, Kishlansky told Tenzer's attorneys that if Tenzer wanted the IRS to consider an offer in compromise, he would have to start to become current on accruing taxes and make all required estimated tax payments. Nevertheless, when Tenzer filed his 1992 return in April of 1993, he failed to pay any of the $135,665 tax due. Nor did Tenzer make estimated tax payments during 1992. Furthermore, Tenzer disregarded Kishlansky's instructions of January 8, 1993 that he divest himself of several assets and begin making monthly payments of $7,000 toward his tax liability. Moreover, when Kishlansky told Tenzer that any offer in compromise would have to be substantial, and that a reasonable offer from Tenzer would be approximately $600,000, Tenzer offered only $250,000. When this amount was firmly (and predictably) rejected, Tenzer indicated not that he would offer more, but rather, that he planned to resubmit the same offer with a more detailed explanation attached. The district court, while noting that the offer was "laughable," nonetheless found that Tenzer had made a bona fide arrangement to pay. *Tenzer*, 950 F.Supp. at 562. That finding is insupportable. Tenzer failed at every turn to make an arrangement to pay, notwithstanding the opportunities extended by the IRS to do so. Thus, having thoroughly failed to bring himself within the letter of the voluntary disclosure policy, Tenzer cannot now claim the benefits of any protection it affords.

II. Solicitation of 1990 Return

Section (31)360(2) of the CCDM, entitled "Solicitation of Returns," provides in relevant part that "[a]bsent unusual circumstances prosecution should not be recommended when a return is solicited and received prior to the taxpayer being contacted by the Criminal Investigation Division." CCDM §(31)360(2)(b)(2). The government argues that the district court erred in finding Count Four of the Information, which relates to Tenzer's 1990 tax return, was barred by the IRS's failure to adhere to its non-solicitation policy. We agree.

Although an individual might be entitled to relief where an agency fails to adhere to its rules or regulations, *see Waldron v. INS*, 17 F.3d 511, 518 (2d Cir.1994), this case does not implicate a rule or regulation of the IRS. First, the policy merely advises agents that prosecution generally should not be recommended because solicitation will be detrimental to the prosecution. *See* CCDM § 31(360)(2)(b) ("The Department of Justice considers the active solicitation of a return as detrimental to a criminal case in that the defense can be expected to argue that the prosecution was instituted because of the unsuccessful attempt to dispose of the matter civilly and as a substitute for unsuccessful collection."). Rather than providing a rule governing when prosecution should be recommended, the non-solicitation policy is only one of several factors to be considered before referring a case for prosecution. The CCDM in no way prohibits prosecution in every case where there has been a solicitation and cannot possibly be construed as a grant of immunity to a taxpayer who files a return in response to solicitation.

Moreover, neither Tenzer nor the public may reasonably rely on the IRS's non- solicitation policy. The policy is a purely internal one, designed for the guidance of IRS agents. It is neither directed to the public nor publicized. Indeed,

Tenzer's highly sophisticated counsel had never heard of the policy until preparing for the hearing, and Tenzer does not argue that he was aware of the policy. Therefore, the district court improperly determined that the IRS's non-solicitation policy provided an independent basis for dismissal of Count Four of the Information.

III. Suppression of Evidence

Tenzer argues that, if we allow his prosecution to go forward, we should suppress all of his voluntarily produced documents and the fruits thereof, pursuant to *Shotwell*, 371 U.S. at 347, 83 S.Ct. at 453. In particular, Tenzer argues that his disclosures were made in reliance on the promises by the government that he would not be prosecuted. [2] We disagree.

Under *Shotwell*, evidence obtained under a promise of immunity must be suppressed in any subsequent prosecution. Id. However, *Shotwell* also held that the IRS's pre-1952 voluntary disclosure policy was not a promise of immunity in the coercive sense. *See id.* at 348-49, 83 S.Ct. at 453-54 ("The voluntary disclosure policy left them wholly free to disclose or not as they pleased. In choosing to act as they did, petitioners, far from being the victims of that policy, were volunteers for its benefits."). [3] Because neither the pre- nor post-1952 versions of the voluntary disclosure policy are promises of immunity for Fifth Amendment purposes, there

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[2] Although brought before the district court as an alternative to dismissing the Information, the district court did not reach this claim.

[3] Tenzer also argues that Kishlansky represented that he was not the subject of criminal investigation, and thus tricked him into voluntarily disclosing incriminating information. Tenzer claims that the voluntarily disclosed documents should be suppressed because, under *United States v. Tweel*, 550 F.2d 297, 299 (5th Cir.1977), information voluntarily produced by a taxpayer cooperating with what he believes to be a civil investigation must be suppressed if he was misled and the investigation really was criminal. However, the district court found that Tenzer was not misled into believing that a criminal investigation would not occur. Rather, when asked, Kishlansky told him that no criminal investigation was underway at that time. There is no clear error in the district court's finding that Tenzer was not misled.

is no basis in law to support suppression of Tenzer's voluntarily disclosed documents.

CONCLUSION

Reversed and remanded.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

GEORGE LANGE III
CLERK

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square in the City of New York, on the 6th day of November on thousand nine hundred and ninety-seven

Present:

Hon. Roger J. Miner

Hon. J. McLaughlin

Hon. E. Nickerson

CIRCUIT JUDGES

USA 96-1653

v.

Tenzer

A petition for rehearing having been filed herein by James Tenzer

Upon consideration thereof, it is

Ordered that said petition be and hereby is DENIED.

GEORGE LANGE III, Clerk

By /s/
Beth J. Meador
Administrative
Attorney

26 U.S.C. §7203. Willful failure to file return, supply information, or pay tax

Any person required under this title to pay any estimated tax or tax, or required by this title or by regulations made under authority thereof to make a return, keep any records, or supply any information, who willfully fails to pay such estimated tax or tax, make such return, keep such records, or supply such information, at the time or times required by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than $25,000 ($100,000 in the case of a corporation), or imprisoned not more than 1 year, or both, together with the costs of prosecution. In the case of any person with respect to whom there is a failure to pay any estimated tax, this section shall not apply to such person with respect to such failure if there is no addition to tax under section 6654 or 6655 with respect to such failure. In the case of a willful violation of any provision of section 60501I, the first sentence of this section shall be applied by substituting "5 years" for "1 year."

26 U.S.C. §7122. Compromises

(a) **Authorization.**. - The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

(b) **Record.** - Whenever a compromise is made by the Secretary in any case, there shall be placed on file in the office of the Secretary the opinion of the General Counsel for the Department of the Treasury or his delegate, with his reasons therefor, with a statement of --

(1) The amount of tax assessed;

(2) The amount of interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed; and

(3) The amount actually paid in accordance with the terms of the compromise.

Notwithstanding the foregoing provisions of this subsection, no such opinion shall be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) is less than $500.

26 C.F.R. §301.7122-1. Compromises

* * *

(d) Procedure with respect to offers in compromise -- (1) Submission of Offers. Offers in compromise shall be submitted on forms prescribed by the Internal Revenue Service which may be obtained from district directors of internal revenue, and should generally be accompanied by a remittance representing the amount of the compromise offer or a deposit if the offer provides for future installments If the final payment on an accepted offer is contingent upon the immediate or simultaneous release of a tax lien in whole or in part, such payment must be in cash, or in the form of a certified, cashier's, or treasurer's check drawn on any bank or trust company incorporated under the laws of the United States or any State, Territory, or possession of the United States, or by a U.S. postal, bank, express or telegraph money order.

(2) Stay of collection. The submission of an offer in compromise shall not automatically operate to stay the collection of any tax liability. However, enforcement of collection may be deferred if the interests of the United States shall not be jeopardized thereby.

(3) Acceptance. An offer in compromise shall be considered accepted only when the proponent thereof is so notified in writing. As a condition to accepting an offer in compromise, the taxpayer may be required to enter into any collateral agreement or to post any security which is deemed necessary for the protection of the interests of the United States.

(4) Withdrawal or rejection. An offer in compromise may be withdrawn by the proponent at any time prior to its acceptance. In the event an offer is rejected, the proponent shall be promptly notified in writing. Frivolous offers or offers submitted for the purpose of delaying the collection of tax liabilities shall be immediately rejected. If an offer in compromise is withdrawn or rejected, the amount tendered with the offer, including all installments paid, shall be refunded without interest, unless the taxpayer has stated or agreed that the amount tendered may be applied to the liability with respect to which the offer was submitted.

26 CFR §601.203 Offers in Compromise

(a) General. (1) The Commissioner may compromise, in accordance with the provisions of section 7122 of the Code, any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense. Certain functions of the Commissioner with respect to compromise of civil cases involving liability of $100,000 or more, based solely on doubt as to liability, have been delegated to regional commissioners and, for cases arising in the District Office, Foreign Operations District, to the Assistant Commissioner (Compliance). The authority concerning liability of $100,000 or more based on doubt as to the collectibility or doubt as to both collectibility and liability has been delegated to the Director, Collection Division and regional commissioners. The authority with respect to compromise of civil cases involving liability under $100,000, and of certain specific penalties has been delegated to district directors, assistant district directors (including the District Director and Assistant District Director, Foreign Operations District), regional directors of Appeals, and chiefs and associate chiefs, Appeals offices. The authority concerning offers in compromise of penalties based solely on doubt as to liability, if the liability is less than $100,000, has also been delegated to service center directors and assistant service center directors. In civil cases involving liability of $500 or over and in criminal cases the functions of the General Counsel are performed by the Chief Counsel for the Internal Revenue Service. These functions are performed in the District Counsel, Regional Counsel, or National Office as appropriate. (See also paragraph (c) of this section.) In cases arising under chapters 51, 52, and 53 of the Code, offers are acted upon by the Bureau of Alcohol, Tobacco and Firearms.

(2) An Offer in compromise of taxes, interest, delinquency penalties, or specific penalties may be based on either inability to pay or doubt as to liability. Offers in compromise arise usually when payments of assessed liabilities are demanded, penalties for delinquency in filing returns are asserted, or specific civil or criminal penalties are incurred by taxpayers. A criminal liability will not be compromised unless it involves only the regulatory provisions of the Internal Revenue Code and related statutes. However, if the violations involving the regulatory provisions are deliberate and with intent to defraud, the criminal liabilities will

not be compromised.

(b) Use of prescribed form. Offers in compromise are required to be submitted on Form 656, properly executed, and accompanied by a financial statement on Form 433 (if based on inability to pay). Form 656 is used in all cases regardless of whether the amount of the offer is tendered in full at the time the offer is filed or the amount of the offer is to be paid by deferred payment or payments. Copies of Form 656 and Form 433 may be obtained from district directors. An offer in compromise, should be filed with the district director or service center director.

(c) Consideration of offer. (1) An offer in compromise is first considered by the director having jurisdiction. Except in certain penalty cases, an investigation of the basis of the offer is required. The examining officer makes a written recommendation for acceptance or rejection of the offer. If the director has jurisdiction over the processing of the offer he or she will:

(i) Reject the offer, or

(ii) Accept the offer if it involves a civil liability under $500, or

(iii) Accept the offer if it involves a civil liability of $500 or more, but less than $100,000, or involves a specific penalty and the District Counsel concurs in the acceptance of the offer, or

(iv) Recommend to the Regional Commissioner the acceptance of the offer if it involves a civil liability of $100,000 or over.

(2)(i) If the district director does not have jurisdiction over the entire processing of the offer, the offer is transmitted to the appropriate District Counsel if the case is one in which:

(a) Recommendations for prosecution are pending in the Office of the Chief Counsel, the Department of Justice, or in an office of a United States attorney, including cases in which criminal proceedings have been instituted but not disposed of and related cases in which offers in compromise have been submitted or are pending;

(b) The taxpayer is in receivership or is involved in a proceeding under any provision of the Bankruptcy Act;

(c) The taxpayer is deceased joint liability cases, where either taxpayer is deceased.

(d) A proposal is made to discharge property from the effect of a tax lien or to subordinate the lien or liens;

(e) An insolvent bank is involved;

(f) An assignment for the benefit of creditors is involved;
(g) A liquidation proceeding is involved; or
(h) Court proceedings are pending, except Tax Court cases.
(ii) The District Counsel considers and processes offers submitted in cased described in paragraphs (c)(2)(i)(a) through (h) of this section and forwards those offers to the district director, service center director, Regional Counsel, or Office of Chief Counsel in Washington, as appropriate.
(iii) In those cases described in (a) of subdivision (i) of this subparagraph no investigation will be made unless specifically requested by the office having jurisdiction of the criminal case.
(iv) In those cases described in (b) through (h) of subdivision (i) of this subparagraph the district director retains the duplicate copy of the offer and the financial statement for investigation. After investigation, the district director transmits to the appropriate District Counsel for consideration and processing his or her recommendation for acceptance or rejection of the offer together with the examining officer's report of the investigation.
(3) The district directors, assistant district directors, (including the District Director and Assistant District Director, Foreign Operations District), service center directors, assistant service center directors, Regional Directors of Appeals Offices are authorized to reject any offer in compromise referred for their consideration. Unacceptable offers considered by the District Counsel, Regional Counsel, or Office of Chief Counsel in Washington, or the Appeals office are also rejected by the district directors (including the Director, Foreign Operations District), as applicable. If an offer is not accepted, the taxpayer is promptly notified of the rejection that offer. If an offer is rejected, the sum submitted with the offer is returned to the proponent, unless the taxpayer authorizes application of the sum offered to the tax liability. Each Regional Commissioner will perform a post review of offers accepted, rejected, or withdraw in the district director's office if the offer covers liabilities of $5,000 or more. The post review will cover a sampling of cases processed by the Collection function and all cases processed by the Examination function.
(4) If an offer involving unpaid liability of $100,000 or more is considered acceptable by the office having jurisdiction over the offer, a recommendation for acceptance is forwarded to the National Office or Regional Office, as appropriate for review. If

the recommendation for acceptance is approved, the offer is forwarded to the Regional Counsel or Office of Chief Counsel in Washington, as appropriate, for approval. After approval by the Regional Counsel or Office of Chief Counsel in Washington, as appropriate, it is forwarded to the Assistant Commissioner (Compliance), Director, Collection Division, or Regional Commissioner, as appropriate for acceptance. The taxpayer is notified of the acceptance of the in accordance with its terms. Acceptance of an offer in compromise of civil liabilities does not remit criminal liabilities, nor does acceptance of an offer in compromise of criminal liabilities remit civil liabilities.

(d) Conferences. Before filing a formal offer in compromise, a taxpayer may request a meeting in the office which would have jurisdiction over the offer to explore the possibilities of compromising unpaid tax liability. After all investigations have been made, the taxpayer may also request a meeting in the office having jurisdiction of the offer to determine the amount which may be accepted as a compromise. If agreement is not reached at such meeting and the district director has processing jurisdiction over the offer, the taxpayer may request consideration of the case by an Appeals office. The request may be in writing or oral. If the tax, penalty, and assessed (but not accrued) interest sought to be compromised exceeds ($2,500 for any return, taxable year or taxable period a written protest is required. Taxpayers and their representatives are required to comply with the applicable conference and practice requirements. *See* Subpart E of this Part.

§342.142 (-693)
Guidelines

(1) Special agents should advise taxpayers who want to make a voluntary disclosure that a voluntary disclosure does not bar criminal prosecution. It will be considered with all other factors in the investigation when deciding whether to recommend prosecution.

(2) A voluntary disclosure occurs when the communication is:

(a) Truthful;
(b) Timely;
(c) Complete; and
(d) When the taxpayer shows a willingness to cooperate (and in fact cooperates) with the IRS in determining his/her correct tax liability.

(3) The Service has a long-standing practice of not recommending criminal prosecution arising from an individuals failure to file one or more returns in situations where the individual:

(a) Informed the Service that he/she has not filed tax returns for one or more taxable periods;
(b) Had only legal source income (*i.e.*, no part of the income was earned from activity which is illegal under federal or state law);
(c) Made the disclosure prior to being contacted by the Service; for this purpose, contacted by the Service means that the taxpayer and/or his/her representative has received notification by the Service in the form of a telephone call, letter, or personal visit that the taxpayer is under criminal investigation;
(d) Either filed a true and correct tax return or cooperated with the Service in ascertaining his/her correct liability; and

(e) Either made full payment of the amounts due or in those situations where the taxpayer was unable to make full payment, made bona fide arrangements to pay.

(4) Special agents are encouraged to consult District Counsel on voluntary disclosure.

(5) The IRS' voluntary disclosure practice creates no substantive or procedural rights for taxpayers, but rather is a matter of Internal IRS practice, provided solely for guidance to IRS personnel.

(6) A voluntary disclosure can not be made anonymously. Any plan by a taxpayer, or his/her representative, to resolve a tax liability, file a correct tax return(s) or offer payment of taxes for an anonymous client will not be considered a voluntary disclosure.

(7) Pattern Letter 2527 (P) (Exhibit 300-35) is a sample letter that may be used to respond to a situation where a taxpayer's representative forwards a letter with payment from an anonymous taxpayer.